

RD AN No. 3617 (4279-B)
February 15, 2001

SUBJECT: Business and Industry Guaranteed Loan Program
Calculation of Tangible Balance Sheet Equity

TO: State Directors, Rural Development

ATTN: Business Programs Directors

PURPOSE/INTENDED OUTCOME:

Several Rural Development State Offices have requested clarification of how to calculate tangible balance sheet equity to ensure compliance with the equity requirements contained in RD Instruction 4279-B, section 4279.131(d). Pursuant to section 4279.131(d), tangible balance sheet equity is to be determined in accordance with Generally Accepted Accounting Principles (GAAP). The purpose of this Administrative Notice (AN) is to provide the requested clarification.

COMPARISON WITH PREVIOUS AN:

No previous AN has been issued on this subject.

DEFINITIONS:

APPRAISAL SURPLUS - The difference between the current market value of an asset and its depreciated book value, when the market value is higher. GAAP requires assets to be reflected at the lower of cost or market value on a balance sheet.

INTANGIBLE ASSETS – A non-current asset having no physical substance. Intangible assets can be calculated by deducting tangible assets from total assets. Examples of intangible assets include, but are not limited to, goodwill, copyrights, franchises, licenses, trademarks, patents, mailing lists, subscription lists, contracts, and proprietary rights. For further guidance, see the attachment to this AN which provides a non-exclusive list of intangible assets.

Total Assets – Tangible Assets = Intangible Assets

EXPIRATION DATE:
February 28, 2002

FILING INSTRUCTIONS:
Preceding RD Instruction 4279-B

SUBORDINATED DEBT – Debt that is junior in claim on assets to other debt.

TANGIBLE ASSETS – An asset having physical substance. Tangible assets can be calculated by subtracting intangible assets from total assets. A non-exclusive list of examples is provided in the attachment to this AN.

$$\text{Total Assets} - \text{Intangible Assets} = \text{Tangible Assets}$$

TANGIBLE STOCKHOLDER'S EQUITY – Tangible assets minus total liabilities or stockholder's equity minus intangible assets.

TOTAL ASSETS – The sum of the business' assets.

TOTAL LIABILITIES – The sum of the business' debts.

TANGIBLE BALANCE SHEET EQUITY – Tangible stockholder's equity divided by tangible assets.

$$\text{Formula 1: } \frac{\text{Tangible Stockholder's Equity}}{\text{Tangible Assets}} = \text{Tangible Balance Sheet Equity}$$

Since Tangible Stockholder's Equity is equal to Tangible Assets minus Total Liabilities, this formula can be rewritten as:

$$\text{Formula 2: } \frac{\text{Tangible Assets} - \text{Total Liabilities}}{\text{Tangible Assets}} = \text{Tangible Balance Sheet Equity}$$

or, using the Stockholder's Equity minus Intangible Assets definition, this formula can be rewritten as:

$$\text{Formula 3: } \frac{\text{Stockholder's Equity} - \text{Intangible Assets}}{\text{Tangible Assets}} = \text{Tangible Balance Sheet Equity}$$

NOTE: A non-exclusive list of examples of assets, liabilities, and equity is provided in the attachment to this AN. The above definitions are intended as guidance for those participating in our Business and Industry (B&I) Guaranteed Loan Program and, with the exception of tangible balance sheet equity and tangible stockholder's equity, are not intended to deviate from GAAP.

IMPLEMENTATION RESPONSIBILITIES:

GENERAL

RD Instruction 4279-B, section 4279.131(d), requires tangible balance sheet equity of 10 percent for existing businesses and 20 percent for new businesses. Tangible balance sheet equity reflects the owners' investment in the tangible assets of the business. For startup businesses, tangible balance sheet equity should be calculated from pro forma startup balance sheets.

SUBORDINATED DEBT AND APPRAISAL SURPLUS

Subordinated debt and appraisal surplus may not be used to meet Agency equity requirements. In order to avoid appraisal surplus, assets must be listed at the lower of cost or market value. If the assets have appreciated over time, they must be listed on the balance sheet at cost value. Any improvements to the assets, at cost, may be included.

SOLE PROPRIETORSHIPS

Sole proprietorships, which often submit personal financial statements instead of balance sheets, often intermingle personal and business assets in their application. However, RD Instruction 4279-B, section 4279.131(d), requires the business, versus the individual, to have the requisite Tangible Balance Sheet Equity. Therefore, you can only count assets and liabilities directly attributable to the business in determining Tangible Balance Sheet Equity. Additionally, personal financial statements list assets at market values. When separating the business assets from personal assets, the business assets must be valued at the lower of cost or market value before calculating Tangible Balance Sheet Equity.

EXAMPLES

Scenario 1. The balance sheet reflects \$100,000 in tangible assets, \$80,000 in liabilities, and \$20,000 in equity. Tangible Balance Sheet Equity would be calculated as follows:

$$\frac{\text{Tangible Stockholder's Equity}}{\text{Tangible Assets}}$$

Since "Tangible Stockholder's Equity" is defined as "Tangible Assets minus Total Liabilities" in the definitions above, it can be substituted in this formula as follows:

$$\frac{\text{Tangible Assets} - \text{Total Liabilities}}{\text{Tangible Assets}}$$

Since all of these numbers are known from the balance sheet, they can be inserted into the formulas as follows:

$$\frac{\$100,000 - \$80,000}{\$100,000} \quad \text{which simplifies to 20 percent.}$$

Scenario 2. Assume the same facts as Scenario 1, except \$10,000 of the total assets are intangible. Now tangible assets would be calculated as follows:

$$\text{Tangible Assets} = \text{Total Assets} - \text{Intangible Assets} = \$100,000 - \$10,000 = \$90,000.$$

Using the second formula for calculating Tangible Balance Sheet Equity results in the following calculation:

$$\frac{\text{Tangible Assets} - \text{Total Liabilities}}{\text{Tangible Assets}} = \frac{\$90,000 - \$80,000}{\$90,000} = 11.1 \text{ percent}$$

You can take an interim balance sheet and adjust it to reflect the impact of the loan and its uses by adding in assets acquired and the resulting debt. Then you can calculate the impact of the loan on Tangible Balance Sheet Equity. This will give you an estimate of the Tangible Balance Sheet Equity assuming no losses or profits from the date of the interim statement until Loan Note Guarantee issuance.

Scenario 3. Assume the same facts of Scenario 2 and that a loan has been requested for \$50,000 to buy new equipment. Total assets and liabilities would increase by \$50,000 each, and, therefore, stockholder's equity would remain unchanged. Using the second formula for calculating Tangible Balance Sheet Equity results in the following calculation:

$$\begin{aligned} & \frac{\text{Tangible Assets} - \text{Total Liabilities}}{\text{Tangible Assets}} = \frac{(\$90,000 + \$50,000) - (\$80,000 + \$50,000)}{(\$90,000 + \$50,000)} \\ & = \frac{\$140,000 - \$130,000}{\$140,000} = 7.1 \text{ percent} \end{aligned}$$

As you can see, this results in an insufficient percent of Tangible Balance Sheet Equity. As demonstrated in the next scenario, one solution, assuming this is an existing business, would be to decrease the loan amount by \$4,000 and require a tangible asset contribution of the same amount.

Scenario 4. Assume the same facts as Scenario 3, but with the loan reduced by \$4,000 and a tangible equity contribution of \$4,000 by the applicant. Tangible assets would stay the same (the \$4,000 loss in loan proceeds to purchase equipment would be replaced by the applicant's additional \$4,000 contribution to stockholder's equity). Since the B&I loan will be \$4,000 less, total liabilities will be reduced accordingly. Then using the second formula for calculating Tangible Balance Sheet Equity results in the following calculation:

$$\frac{\text{Tangible Assets} - \text{Total Liabilities}}{\text{Tangible Assets}} = \frac{\$140,000 - (\$130,000 - \$4,000)}{\$140,000}$$

$$\frac{\$140,000 - \$126,000}{\$140,000} = 10 \text{ percent.}$$

If you have any questions, please contact the Business and Industry Division directly, (202) 690-4103.

(Signed by William F. Hagy III)

WILLIAM F. HAGY III
Acting Administrator
Rural Business-Cooperative Service

Attachment

ASSETS	C U R R E N T	N O N C U R R E N T	I N T A N G I B L E		C U R R E N T	N O N C U R R E N T	I N T A N G I B L E
Accounts Receivable				Advertising			X
Trade (less reserves)	X			Automobiles		X	
From Affiliate, if concern in healthy shape, and accounts are being paid on regular terms.	X			Bills Receivable (same as Accounts Receivable)			
				Bond Discount			X
				Bonds	X		
From Affiliate, if concern in unhealthy shape, and accounts are not being paid on regular terms.			X	Bookplates At Cost Metal Value		X	X
				Bottling Rights			X
From Directors		X		Brands, Trade			X
From Employees		X		Building and Loan Shares	X		
From Officers		X		Buildings		X	
From Partners		X		Cash			
From subsidiary if concern				In Bank	X		
in healthy shape, and receivables are being paid on regular terms.	X			In Closed Bank		X	
				In Sinking Fund		X	
				On Hand	X		
From subsidiary if concern				Restricted		X	
is in unhealthy shape				Cash Value of Life Insurance		X	
And receivables are not paid on regular terms.			X	Catalogs			X
				Claims for refunds under carry back provisions of Tax Law	X		
Miscellaneous		X		Coal Lands		X	
Other		X		Contracts			X
Advances				Copyrights			X
For Merchandise	X			Debenture Discount			X
For Mining Royalties		X		Deferred Charge (see also			
For Traveling		X		Prepaid items)		X	
To Affiliate		X		Deficit (profit and loss)			X
To Employees		X		Delivery Equipment		X	

To Subsidiary			X						
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ASSETS	C	N	I	*For leasehold improvements to count as tangible assets, the lease must be a capital lease. i.e., long-term, lessee retains asset at the end of lease, etc.	C	N	I
	U	O	N		U	O	N
	R	N	T		R	N	T
	R	C	A		R	C	A
	E	U	N		E	U	N
	N	R	G		N	R	G
	T	R	I		T	R	I
		E	B			E	B
		N	L			N	L
		T	E			T	E
Deposits				Inventory			
With Factor	X			Advances on Merchandise	X		
With Mutual Ins. Co.		X		Finished Goods	X		
With Workman's Comp. Commission		X		In Transit	X		
Designs			X	On Consignment	X		
Development Expense			X	Raw Materials	X		
Dies (at cost)		X		Supplies		X	
Docks		X		Work in Process	X		
Drawings			X	Investments		X	
Emergency Plant Facilities		X		Investments in and advances to subsidiaries & affiliates		X	
Equipment		X		Land		X	
Experimental Expense			X	Lasts			X
Exploration Expense			X	Leasehold Improvements *		X	
Federal Government Securities (See United States Government Securities)				Leaseholds			X
Financing Expense			X	Licenses			X
Fixed Assets		X		Life Ins. Cash Surrender Value		X	
Fixtures		X		Limited Securities	X		
Formulas			X	Loan to Affiliate		X	
Franchises			X	Loan to Subsidiary		X	
Furniture		X		Machinery		X	
Goodwill			X	Magazine Titles			X
Government Securities (See United States Government Securities)				Mailing Lists			X
Improvements		X		Maintenance materials & parts		X	
Insurance Deposits		X		Marketable Securities	X		
Insurance Premiums, Prepaid		X		Merchandise (see Inventory)			
Interest, Accrued		X		Mines		X	
				Miscellaneous Receivables		X	
				Models			X
				Mortgages Receivables		X	
				Municipal Bonds	X		
				Municipal Bonds in Default		X	

ASSETS	C U R R E N T	N O N C U R R E N T	I N T A N G I B L E		C U R R E N T	N O N C U R R E N T	I N T A N G I B L E
Notes Receivable (Same as Accounts Receivable)				Tools		X	
				Tracings			X
Organization Expense			X	Trade Acceptances	X		
Packaging and Shipping Items		X		Trade Brand			X
Patents			X	Trademarks			X
Patterns			X	Trade Name			X
Pension Funds		X		Treasury Bonds		X	
Plant		X		Treasury Stock		X	
Prepaid				Trucks		X	
Insurance		X		Unamortized mortgage or bond expense	X		
Rent		X		United States Government Securities	X		
Royalties		X		Unlisted Securities*		X	
Supplies		X		Vessels		X	
Taxes		X					
Processes			X				
Profit and Loss (deficit)			X				
Property		X					
Quarries		X					
Real Estate		X					
Research Expense			X				
Revenue Stamps	X						
Rights, Publishing			X				
Royalty, Prepaid		X					
Securities		X					
Ships		X					
Sight Drafts Outstanding	X						
Sinking Fund		X					
State Bonds	X						
Stock Subscription			X				
Subscription Lists			X				
Surplus (deficit)			X				
Timber (standing or uncut)		X					

***Footnote:** Securities listed on National security exchange or having an active over-the-counter market may be classified as current if readily marketable and valued not in excess of market. Other securities, except Federal and State bonds, should be classified as non-current.

LIABILITIES & EQUITY	C U R R E N T	N O N C U R R E N T	E Q U I T Y		C U R R E N T	N O N C U R R E N T	E Q U I T Y
Accounts Payable				Capital Surplus			X
For Merchandise	X			Chattel Mortgage	X		
For Services	X			Common Stock			X
To Directors	X			Conditional Bill of Sale	X		
To Employees	X			Contracts Payable	X		
To Officers	X			Credit Balance	X		
To Partners	X			Debentures			
To Related Concerns	X			Amount maturing w/in 1 yr.	X		
Sundry	X			Amount maturing after 1 yr.		X	
Accruals				Deferred Credits or Income		X	
Commission	X			Deferred Income	X		
Interest	X			Deposits			
Other Expenses	X			From Customers	X		
Payroll	X			From Employees	X		
Rent	X			From Officers	X		
Salaries	X			From Salesman	X		
Taxes	X			Depreciation (deduct from			
Wages	X			Related Assets)	X		
Advances from Customers	X			Dividends Payable	X		
Bills Payable (same as				Donated Surplus		X	
Notes Payable)				Due Factor	X		
Bonds				Earned Surplus		X	
Amount maturing w/in 1 yr.	X			Employees' Deposits	X		
Amount maturing after 1 yr.		X		Federal Income Taxes	X		
No Definite Maturity Date	X			Funded Debt			
Capital (if partnership or				Amount maturing w/in 1 yr.	X		
proprietorship)			X	Amount maturing after 1 yr.		X	
Capital Stock				Income Taxes	X		
A, B, C Stock			X	Loans from Factor	X		
Common Stock			X	Loans Payable (same as		X	
Minority Interest		X		Notes Payable)	X		
Preferred Stock			X	Minority Interest		X	

LIABILITIES AND EQUITY	C U R R E N T	N O N C U R R E N T	E Q U I T Y		C U R R E N T	N O N C U R R E N T	E Q U I T Y
Mortgages				Salaries	X		
Amount maturing w/in 1 yr.	X			Salesman's Deposits	X		
Amount maturing after 1 yr.		X		Sales Lien	X		
Net Worth			X	Separation Allowances	X		
Notes Payable				Social Security Taxes	X		
For Merchandise	X			Stock			X
To Individuals	X			Stock Subscriptions	X		
To Banks	X			Subordinated Debentures			
To Others	X			(same as Debentures)	X		
To Partners	X			Sundry Accounts Payable	X		
To Stockholders	X			Surplus Account			
Term Loans (same as Bonds)	X			Capital Surplus			X
Officers' Deposits	X			Deficit (deduct)			X
Paid-in-Surplus			X	Donated			X
Preferred Stock			X	Earned			X
Provision for Income Taxes	X			Paid-in			X
Rent, Unpaid	X			Profit/Loss			X
Reserves				Surplus			X
Bad Debts (deduct from A/R)				From Appreciation			
Contingencies		X		From Undivided Profits			X
Depletion (deduct from Related Assets)				Taxes, unpaid	X		
Discounts (deduct from A/R)				Taxes, Withheld at Source	X		
Inventory Adjustments (deduct from Related Assets)				Term Loans (same as Bonds)			
Obsolescence (deduct from Related Assets)				Trade Acceptances Payable	X		
Retirement Capital Stock	X			Unearned Income		X	
Self-Insurance		X		Wages, Unpaid	X		
Taxes	X						
Unexpired Subscriptions		X					
Unrealized Profit		X					